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APR 26 1946

CHARLES ELMORE CROPLEY
CLERK

Supreme Court of the United States

OCTOBER TERM, 1945

No. 1160

RANDOLPH PHILLIPS,

Petitioner,

v.

SECURITIES and EXCHANGE COMMISSION and THE UNITED CORPORATION,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

RANDOLPH PHILLIPS,
Pro Se

JULIEN CORNELL,
Of Counsel

April 13, 1946

APPEAL PRINTING CO., INC., 120 CEDAR ST., NEW YORK, WO 2-3242

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To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Your petitioner Randolph Phillips respectfully prays that a writ of certiorari issue to review the decree of the Circuit Court of Appeals for the Second Circuit rendered in this cause on January 31, 1946 (R. Part IV, XII), which decree affirmed certain orders of the Securities and Exchange Commission (R. Part II, 61 and 62 of 3a) approving a plan of reorganization filed under Section 11 (e) of the Public Utility Holding Company Act of 1935.

Opinions Below

The findings, opinion and order of the Securities and Exchange Commission are set forth in Holding Company

Act Release No. 5440 (R. Part II, 3a). The opinion of the Circuit Court of Appeals (R. Part IV) is reported in 153 F. (2d) 27.

Jurisdiction

The decree of the Circuit Court of Appeals was entered on January 31, 1946 (R. Part IV, XII). The jurisdiction of this Court is invoked under Section 24 (a) of the Public Utility Holding Company Act.

Questions Presented

1. Does the Securities and Exchange Commission have the power under Section 11 (e) of the Public Utility Holding Company Act to override the laws of a State respecting corporate liquidations and reorganizations without first obtaining the approval and enforcement of its overriding order by a District Court?

2. In view of the fact that (1) the evidence was uncontroverted that the management of The United Corporation has been able to perpetuate itself in office by requiring that only 25 per cent of the voting stock was necessary to make a quorum for the election of directors, and (2) that the management had never received the vote of a majority of the voting stock for its election at any time in the preceding six years, and (3) that 18,000 stockholders voting together were unable to seat a single director because the vote was counted non-cumulatively; and in view of the fact that the Commission is directed under Section 11 (b) (2) of the Act to require that a registered holding company take steps to ensure that voting power is fairly and equitably distributed "as soon as practicable after January 1, 1938" and in view of the fact that the Commission has the power under Section 11 (e) to modify any plan filed thereunder

so as to meet the standards of Section 11 (b) (2), did the Commission err in denying amendments to a plan of reorganization which would effect such a distribution of voting power where such denial was based solely on the ground that the amendments were not "germane" to the plan as proposed by the company's management and as filed under Section 11 (e) of the Act?

Statute Involved

The relevant portions of Section 11 of the Public Utility Holding Company Act are:

> "SIMPLIFICATION OF HOLDING COMPANY SYSTEMS
> SEC. 11 * * *
>
> (b) It shall be the duty of the Commission, as soon as practicable after January 1, 1938:
>
> * * * * *
>
> (2) To require, by order, after notice and opportunity for hearing, that each registered holding company, and each subsidiary company thereof, shall take such steps as the Commission shall find necessary to ensure that the corporate structure or continued existence of any company in the holding company system does not unduly or unnecessarily complicate the structure, or unfairly and inequitably distribute voting power among security holders, of such holding-company system. In carrying out the provisions of this paragraph the Commission shall require each registered holding company (and any company in the same holding company system with such holding company) to take such action as the Commission shall find necessary in order that such holding company shall cease to be a holding company with respect to each of its subsidiary companies which itself has a subsidiary company which is a holding company.

Except for the purpose of fairly and equitably distributing voting power among the security holders of such company, nothing in this paragraph shall authorize the Commission to require any change in the corporate structure or existence of any company which is not a holding company, or of any company whose principal business is that of a public-utility company.

The Commission may by order revoke or modify any order previously made under this subsection, if, after notice and opportunity for hearing, it finds that the conditions upon which the order was predicated do not exist. Any order made under this subsection shall be subject to judicial review as provided in Section 24.

(c) Any order under subsection (b) shall be complied with within one year from the date of such order; but the Commission shall, upon a showing (made before or after the entry of such order) that the applicant has been or will be unable in the exercise of due diligence to comply with such order within such time, extend such time for an additional period not exceeding one year if it finds such extension necessary or appropriate in the public interest or for the protection of investors or consumers.

(d) The Commission may apply to a court, in accordance with the provisions of subsection (f) of section 18, to enforce compliance with any order issued under subsection (b). In any such proceeding, the court as a court of equity may, to such extent as it deems necessary for purposes of enforcement of such order, take exclusive jurisdiction and possession of the company or companies and the assets thereof, wherever located; and the court shall have jurisdiction, in any such proceeding, to appoint a trustee, and the court may constitute and appoint the Commission as sole trustee, to hold or administer under the direction of the

court the assets so possessed. In any proceeding for the enforcement of an order of the Commission issued under subsection (b), the trustee with the approval of the court shall have power to dispose of any or all of such assets and, subject to such terms and conditions as the court may prescribe, may make such dispostion in accordance with a fair and equitable reorganization plan which shall have been approved by the Commission after opportunity for hearing. Such reorganization plan may be proposed in the first instance by the Commission, or, subject to such rules and regulations as the Commission may deem necessary or appropriate in the public interest or for the protection of investors, by any person having a bona fide interest (as defined by the rules and regulations of the Commission) in the reorganization.

(e) In accordance with such rules and regulations or order as the Commission may deem necessary or appropriate in the public interest or for the protection of investors or consumers, any registered holding company or any subsidiary company of a registered holding company may, at any time after January 1, 1936, submit a plan to the Commission for the divestment of control, securities, or other assets, or for other action by such company or any subsidiary company thereof for the purpose of enabling such company or any subsidiary company thereof to comply with the provisions of subsection (b). If, after notice and opportunity for hearing, the Commission shall find such plan, as submitted or as modified, necessary to effectuate the provisions of subsection (b) and fair and equitable to the persons affected by such plan, the Commission shall make an order approving such plan; and the Commission, at the request of the company, may apply to a court, in accordance with the provisions of subsection (f) of section 18, to enforce and carry out the terms and provisions of

such plan. If, upon any such application, the court, after notice and opportunity for hearing, shall approve such plan as fair and equitable and as appropriate to effectuate the provisions of section 11, the court as a court of equity may, to such extent as it deems necessary for the purpose of carrying out the terms and provisions of such plan, take exclusive jurisdiction and possession of the company or companies and the assets thereof, wherever located; and the court shall have jurisdiction to appoint a trustee, and the court may constitute and appoint the Commission as sole trustee, to hold or administer, under the direction of the court and in accordance with the plan theretofore approved by the court and the Commission, the assets so possessed."

* * * * * * *

Statement

Petitioner is the owner of 1100 shares of Common Stock and the attorney-in-fact for 18,426 stockholders owning 1,807,436 shares of the Preferred and Common stock of The United Corporation. His powers as attorney-in-fact derive from proxies executed by the said stockholders for use at the Annual Meeting of the Corporation in 1944, which proxies are not to be used to represent any stockholder in any proceeding in any court, but were given on the express understanding that petitioner himself would proceed in the courts, if necessary, to protect the interests of himself and other stockholders (R. Part II, p. 29a).

(a) Background of the Orders

The United Corporation is a public utility holding company and is incorporated under the laws of the State of Delaware. Its capital structure is free of debt and con-

sists exclusively of two classes of stock, Preferred and Common. By its order of August 14, 1943 the Securities and Exchange Commission directed United to reduce these two classes to one class of stock, namely Common. *In the Matter of The United Corporation,* Holding Co. Act Release No. 4478. Petitioner at no time has complained of this order. The assets of United consist almost exclusively of stocks in public utility holding companies and the 1943 order also required United to cease to be a holding company. This direction at no time has been the subject of petitioner's complaint. Petitioner's objections are directed at the methods by which United at the Commission's direction has sought to comply with the 1943 order.

United refused to register with the Commission under the Act until March 28, 1938, previously contending for two and a half years that the Act was unconstitutional. At no time from 1938 to 1944 did it take or propose to take any steps that the Commission considered to be an effective compliance with the terms of Section 11 (b) (2) of the Act, the section commonly known as the corporate simplification section of the statute. As a result of this long period of non-compliance, Petitioner in February 1943 and 1944 instituted contests for proxies in an effort to oust the incumbent management of the Company (See R. Part II, pp. 23-25a, for a brief summary of the contests). Some 14 to 18,000 stockholders gave Petitioner their proxies but Petitioner's efforts were unsuccessful and the management was reelected to office. Prior to the first contest the management had proposed to the Commission that it be allowed to effect a certain Plan of compliance with the Act, which Plan was disapproved by the Commission in its Findings and Opinion accompanying the order of August 14, 1943. During the course of the proceedings, however, the Company made clear at the insistence of

Counsel for the Commission that it proposed its Plan be subject to the approval not only of holders of a majority in number of all its outstanding stocks but of a majority in number of each class of stock. (*Id.*, footnote 124 at p. 51.) The Commission itself in its opinion stated that the change of business proposed by the management of United (from that of a public utility holding company to that of an investment company) would "devote the funds which security holders have invested to a purpose different from that for which they were contributed" and "no such program would be fair which does not require majority approval either of the present preferred and common stock voting by classes, or of the new common stock, should United choose to recapitalize on a one-stock basis before seeking stockholder approval of the proposed new venture" (*Id.*, p. 51-2).

The Commission in its opinion accompanying the orders under review in the present case now contends however, that it "did not suggest, nor had we any intention of suggesting, that a program for eliminating preferred stock and for divestment of assets unretainable under the Act should be the subject of a stockholders' vote" (R. Part II, p. 33). This 1944 interpretation by the Commission should be compared with that of the Company's directors in their first communication to the stockholders after the 1943 order and opinion had been issued in which they stated:

> "After careful consideration, the Board of Directors has concluded not to seek a review of the Commission's decision. * * * Since the disposition of a major part of the securities of the statutory subsidiaries appears in all events to be necessary, it is probable that a first step of compliance will be a proposal for the exchange of some of these securities

for outstanding shares of the Corporation's Preference Stock. Although questions still pending with respect to certain of the Corporation's statutory subsidiaries create very real difficulties, it is hoped that such proposals may be reduced to concrete form for early submission to the Securities and Exchange Commission. *Any such plan will also be subject to approval by stockholders.*" (Emphasis supplied.) (R. Part II, pp. 18-20a.)

This letter was dated September 13, 1943, a month after the Commission's opinion. It shows that the Company's directors understood that principles of equity and law, if not the language of the Commission's opinion, required a vote of stockholders on a "program for eliminating preferred stock and for divestment of assets unretainable under the Act." That the language of the Commission's opinion was understood in the same way by the Commission as by the Company is clear from a brief analysis. The Company could either sell its utility stocks and hold the proceeds for non-utility investment or distribute the stocks or the proceeds from their sale to its stockholders. That is, instead of a distribution to stockholders the Company could use the proceeds of a sale for use as would a non-public utility investment company. That was the only issue to be decided by a vote. The Commission now suggests however that its intention was to require a vote only *after* divestment and elimination of the Preference Stock.

First, it is obvious that the Preference Stockholders could not vote on a program of dissolution versus transformation into an investment company if the Preference Stock had been eliminated from the Company. But the Commission said, furthermore, that if the vote were not had by the "present preferred and common stock" it

should be made by "the new common stock" after recapitalization on a one-stock basis. The last quoted words are omitted from the Commission's latest opinion. For it is obvious that a recapitalization could not take place without the voluntary approval by vote of both classes of stockholders or enforcement of an order of reorganization by a United States District Court under Section 11 (d) or (e) of the Act.

We think it is clear therefore that the Commission suggested and intended in its 1943 opinion as a matter of equity and law to require a vote by the stockholders on any program for compliance with its order of August 14, 1943 or an order by a District Court under Section 11, and that the Commission knew in the absence of such a vote it could enforce the required result by resort to an order of a District Court. That this was likewise the Company's view is the only interpretation consistent with the letter of September 13, 1943, above quoted. After the letter's issuance the Company filed a preliminary plan with the Commission similar in effect to the Plan approved by the orders herein complained of, and this plan included a provision making it subject to stockholders' approval.

(b) The Plan

The Plan which the management of United filed with the Commission proposed that certain of the Company's assets* be offered in exchange for 45 per cent of the Company's Preference Stock. As finally approved by the Commission the assets in question had a cash or market value, as of June 30, 1944, of approximately 46 million dollars, and represented roughly 38 per cent of the Com-

* Common Stock of the Philadelphia Electric Company and cash.

pany's total assets. In a memorandum submitted to the Circuit Court, counsel for the Commission stated:

> "The Commission treated the [Company's] proposal as in effect a plan of reorganization * * *"
>
> "* * * any attempt to dispose of a major proportion of (applicant's) assets and to discharge a substantial proportion of its outstanding Preference Stock liability amounts in substance to a reorganization and calls for application of reorganization standards of fairness."

Article 10 of the Certificate of Incorporation of The United Corporation contains the following provision regarding reorganization which is pursuant to Section 5 (9) of the General Corporation Law of Delaware:

> "If a majority in number representing three-fourths in value of the creditors or class of creditors, and/or of the stockholders or class of stockholders of this corporation, as the case may be, agree to any compromise or arrangement and to any reorganization of this corporation as consequence of such compromise or arrangement, the said compromise or arrangement and the said reorganization shall, if sanctioned by the Court to which the said application has been made, be binding on all the creditors or class of creditors, and/or on all the stockholders or class of stockholders, of this corporation, as the case may be, and also on this corporation."

It is clear from the above that the management of United has no power, except with the requisite stockholder approval, to offer and effect the Plan which is the subject of the orders herein challenged. The Commission, however, found that it was not a Plan requiring stockholder approval under Delaware law because "it

differs *only in form* from that of repurchasing outstanding shares of Preference Stock with cash derived from a sale" of the stocks offered in exchange for the Preference Stock. Petitioner replied that the short answer to this argument is that every reorganization involving an exchange of securities is a purchase of outstanding securities with the assets left in the company. Were such reasoning to prevail the Delaware statute could be subverted in every reorganization made in which Preference Stock or any other security was reorganized. It is well understood that the courts will look to the substance of a transaction and not be deflected by its form. The Circuit Court, however, did not decide this point. The chief and only other support for dispensing with stockholder approval was the Commission's finding that "the requirements of the Act must be met whether or not the stockholders approve. In this respect the Act supersedes State law." Petitioner has never disputed that the requirements of the Act must be met regardless of stockholder approval. The Act specifies, however, a protective procedure which must be followed by the Commission before it can override the requirements of State law; namely, the application by the Commission to a District Court for an order under Section 11 (d) or (e). Petitioner's complaint is that the Commission disregarded both State law and the Act which it is entrusted with administering.

It should also be noted that not only was the Plan of United a reorganization but it was a step in dissolution or liquidation. For, as the Commission's decision recites (R. Part II, p. 3a and pp. 22-23 thereof), "it is the considered judgment of the management that the most feasible method for compliance (with the 1943 order) is to offer further exchanges of portfolio assets for outstanding shares of United's Preference Stock." Under the

Plan herein challenged 45 per cent of the Preference Stock has been exchanged for 38 per cent of the corporation's assets on the basis of June 30, 1944 market values. At this ratio of exchange it will take 84 per cent of United's assets to retire 100 per cent of its Preference Stock. A corporation that is no more than 16 per cent of its original size has been substantially dissolved. However, the Commission has prohibited the existence of even this stump of a corporation as a holding company and it has stated that it would "withhold" issuance of a dissolution order pending on whether or not a majority of United's stockholders vote to continue it in a different business.* Since the management of this corporation has not obtained such a vote more than two years after the Commission's order of August 14, 1943 has been in effect, the only permissible inference from the present record is that the company will be wholly dissolved. Section 39 of the General Corporation Law of Delaware requires for dissolution the consent of two-thirds in interest of the stockholders having voting power. The statute obviously requires that the question of dissolution be acted upon by the stockholders prior to any irrevocable act in that direction and not after a dissolution has been substantially achieved. It may well be the desire of the stockholders that instead of the present plan or similar plans a one-stock recapitalization be effected and the corporation then be dissolved or that the stocks of the public utility companies be sold and no dissolution take place. Certainly the stockholders' right to determine these questions and especially the question of dissolution will be seriously prejudiced and almost entirely foreclosed by execution without their consent of such plans

* *In the Matter of The United Corporation*, Holding Co. Act Release No. 4478, at page 50.

as that herein reviewed. That the Commission has come round to petitioner's view on this point is made clear by a decision, issued five months after the decision in the present case:

> "The present plan is but a further step in the process of bringing the Northern States system into compliance with that section (11), and these steps must be viewed together. Clearly the Delaware preferred stockholders may not do in two steps what they could not do in one—, namely use Section 11 as a means of depriving the common stock of whatever legitimate investment value it might have in the enterprise absent the readjustments required by Section 11."
>
> *In the Matter of Northern States Power Co.*, Holding Co. Act Release No. 5745.

Petitioner contends that the entire plan or program must be submitted and no such action by the Commission, absent the confirmation of the courts, as was embodied in the orders herein under review can substitute for or override the requirements of the Delaware statute. Again it should be emphasized that petitioner does not dispute that the Commission either on its own motion under Section 11 (d) or at the Company's request under 11 (e) may seek from a District Court and obtain therefrom an order effecting the Plan without a stockholders vote.

(c) Elimination of Vote Provision

At the hearings before the Commission the following additional facts bearing on this issue were brought out:

The Commission's former employee, William M. Hickey, became president of United following the proxy contest of 1943. Although the management won that con-

test, the incumbent president George H. Howard resigned one month later to be followed into office by Hickey, who previously had left the Commission to go into business himself as a public utility consultant.* We quote from the record in the present proceedings:

"By Mr. Phillips:

Q. Now, will you tell us what your chief activities were since your election as president of The United Corporation prior to the issuance of the Securities and Exchange Commission decision in the present proceedings? A. (By Mr. Hickey) My chief activities—

Q. (Interrupting) With respect to The United Corporation. A. (Continuing) were to study the assets of the company and what might be done with them, and the recommendations of the staff of the SEC, and how the company might be able to work out its destiny, and I came to the conclusion that the way that it could best do it would be to try to cooperate with the Securities and Exchange Commission, particularly in view of their decision in the UGI case and in the United Light & Power case.

Q. Which came down when? A. The United Light & Power case came down—well, roughly a year ago.

Q. Just about the time you became president? A. Generally, yes. And the UGI decision, I believe, had come down just before that. And to see if we could not get an order out of the Commission that we could work under—and then commence to obtain results under that order both with respect to The United Corporation itself and with respect to the statutory subsidiaries, and then having arrived at that conclusion I had a number of con-

* Hickey is the second employee of the Commission to become an officer of United, the Commission's former general counsel, John J. Burns, resigning that post to become counsel to United some years earlier. A third former Commission employee is assistant to the president of United.

versations with members of the Securities and Exchange Commission.—

Q. (Interrupting) Do you mean the Commissioners or the employees of the Commission? A. Both.

Q. Both? A. And I believe those discussions led up to the issuance of the particular order that was issued on August 14, 1943. * * *

Q. Will you explain that remark? A. I mean by that I told what I believed could be done and should be done, and in view of those circumstances that that had quite a bearing on the particular order that was issued at that time.

Q. What reason do you have to know that that had a bearing so far as the Commission was concerned in that order." (R. Part II, pp. 6-7a)

At this point counsel for the applicant objected and the Trial Examiner cut off any further questioning along this line. First it should be noted that Mr. Hickey became president in April 1943 and that the public hearings leading up to the order of August 14, 1943 were closed on June 18, 1942 and oral argument on the issues, after filing of the briefs, was heard on October 8, 1942 (Page 3, *In the Matter of The United Corporation,* Holding Company Act Release No. 4478). But despite the public closing of the hearings Mr. Hickey was able, according to his unrebutted testimony, to walk into the offices of the judges, the commissioners, and discuss the issues and subsequently to state that these private discussions led up to the issuance of the particular order in question.* But

* The record discloses that the content of petitioner's private correspondence with the staff of the Commission relating to his proxy statements was revealed by unnamed members of the staff to Mr. Hickey. (R. Part II, pp. 10-11a) Rule X-14A-4 of Regulation X-14 under the Securities Exchange Act of 1934 provides that preliminary copies of proxy statements filed with the Commission "shall be for the information of the Commission only". Yet Mr. Hickey by his own testimony was able to induce a breach of confidence by members of the staff with respect to petitioner's preliminary copies and the correspondence thereon. This is a clear violation of Section 24(c) of the Securities Exchange Act.

although the Commissioners do not challenge this part of the record they do allege that the only conversations held between Mr. Hickey and anybody connected with the Commission with respect to the issues herein reviewed were with members of the Commission's "staff". They also convey the impression that the Commission "concurred" with the advice of the staff *after* instead of before the public hearings. The record, however, shows as follows:

> (1) On January 27, 1944 United formally filed with the Commission its application for approval of the Plan. An earlier draft of the Plan had been discussed with the Commission. This draft provided that the Plan be subject to stockohlders' approval but the provision for the stockholders' vote was deleted after conversations with the staff of the Commission (R. Part II, p. 10a).
>
> (2) This was done after Commissioner Robert O'Brien stated to counsel for The United Corporation that "he (Commissioner O'Brien) considered submitting the plan to a vote of stockholders to be inappropriate because the plan being submitted as a step in compliance with the order of August 14 was not subject to stockholder approval". (R. Part II, p. 40a). This statement by counsel was made, it should be noted before the start of public hearings by the Commission on the plan. At United's annual meeting prior to the hearings, Mr. Hickey confirmed Mr. Smith's statment as follows:
>
> > "I should like to add for the record, to confirm what Mr. Smith has just said, that Commissioner O'Brien also indicated to me that a vote would be inappropriate and that our plan should not provide for a vote; and that in addition to Commissioner O'Brien, other responsible representatives, whom I am willing to name if anyone wants me to name them, made the same point, and, in fact, stressed the point to me." (R. Part II, p. 42a)

Earlier, at the first session of the Annual Meeting of United's stockholders, held on March 1, 1944 (almost two months before the public hearings on the issue), Mr. Hickey stated:

> "The S.E.C. has advised us that they consider it an appropriate first step in compliance with their order of last August. Of course, they still have to go through the hearings there and determine that it is fair and equitable and then issue a report on it, but they consider that this is an appropriate first step. A step of this type is appropriate to meet their order. Hearings are going to commence later this month * * *
>
> "Now, it was originally planned when we discussed this last September and worked it out that we were going to submit it to our stockholders for their approval. Then we had a number of discussions with the Securities and Exchange Commission, *the members of the Commission* and members of the staff, and they indicated to us that in their opinion such a plan, since it would be in compliance with the order of theirs under Section 11 which we would have to comply with, that such approval would be unnecessary and undesirable. *They were so insistent on this point* that we took that provision out of the plan as it was actually filed." (R. Part II, p. 37-8a.) (Emphasis supplied.) * * *
>
> "The Chairman (Mr. Hickey) Will you go up to the counsel of the Securities and Exchange Commission and ask them what they think of me?
>
> "Mr. Miller: I don't have to go up.
>
> "Mr. Phillips: Mr. Hickey has asked Mr. Miller to go to the Securities and Exchange Commission and ask them what they think of him. What do you think they think of you, Mr. Hickey?
>
> "The Chairman: From what I know, they have always been very friendly, and the last time I saw Judge Healy he was very complimentary and told

> me what a great job he thought I was doing, and the last time I saw Bob O'Brien he told me he thought I was doing just the right thing and didn't see how I could do anything else in the way I was handling the business of the company." (R. Part II, p. 39a.)

This is then what the unrebutted evidence shows as to what actually took place between the Company and the Commission in the midst of proxy contests and prior to the public hearings on the Plan. These facts do not bear out the impression of the Commission's decision that the members of the Commission "concurred" with the advice of the "staff" *after* the public hearings. They adjudicated the issue before the hearings, and they so far stepped out of their roles as judicial and impartial administrators as to intervene in the 1944 proxy contest between the management and its opponents.

On September 13, 1943, as above noted, the Company wrote all the stockholders that its plan would be subject to their approval. In January 1944 the plan was formally filed with the Commission after deletion of the provision for the stockholders' vote. Thereupon the management issued its routine appeal for proxies for the annual meeting to be held in March, 1944 and at the same time notified the stockholders of the filing of its plan. (R. Part II, pp. 33-37a). *But no mention was made of the omission of the vote provision.* The Commission allowed this solicitation of votes for re-election of the management to be made without forcing a revelation of the change in the plan and thereby allowed the stockholders to believe that the promise of the September 13th letter still held. Had it not been for Petitioner's action in sending out a proxy appeal on February 12, 1944 (R. Part II, p. 26a) the stockholders would not have learned of the revocation of the promise until after

the directors' re-election and the formal offering of the plan. The Commission, however, permitted the management of United to answer Petitioner's disclosures once the secret came out as follows:

> "It is true that your Board of Directors at first contemplated that a plan would be subject to approval of the stockholders. Thereafter responsible representatives of the Securities and Exchange Commission indicated to us that such a submission would be inappropriate, because the plan of exchange, if approved by the Commission, will be a step taken to comply with the order which the Commission made on August 14, 1943." (R. Part II, p. 35a.)

At the Annual Meeting of the stockholders United's counsel revealed that the letter above quoted was submitted, *prior to publication,* to "the full Commission" which allowed it to go out without objection or exception by any member of the Commission (R. Part II, page 41a).

The above record demonstrates how inaccurate is the following summary in the Commission's opinion:

> "The record indicates that the provision for a stockholders' vote was omitted on the advice of our staff, whose duty it is to advise applicants regarding the requirements of the Act in the light of precedents, including our published opinions and such judicial decisions as may be relevant." (R. Part II, footnote at p. 33 of p. 3a.)

Not only is the record incorrectly summarized but there are no published opinions of the Commission on the point at issue and we say this despite the citations in its decision. We agree that "advice to applicants regarding the *requirements* of the Act" are proper by the "staff". In the present case the Commission knew there had been a proxy fight and that the management's plans would in

all likelihood be contested, and there are no requirements that forbid a vote, as the Commission admitted:

> "Of course there are often alternative methods from which to choose, and it is not necessarily inappropriate to submit to stockholders the particular method chosen by the management * * * (R. Part II, p. 33 of p. 3a.) Although a stockholders' vote is not unheard of in a case of this kind (see *National Power & Light Co.*, 10 S.E.C. 827 (1941)), we are satisfied that there is no necessity for it * * * (R. Part II, footnote of p. 33 of p. 3a.)."

Petitioner objected to the Commission making the findings that there was "no necessity" and "inappropriate" in advance of public hearings and presentation of the evidence and Petitioner's views, for here was a question involving equitable as well as legal considerations. Administrators who have committed themselves to findings and allowed them to be publicized in advance of hearings may find themselves psychologically incapable of giving that fair and impartial consideration to a contrary argument that they would have possessed had they not committed themselves to the opposite position.

> "A man who has buried himself in one side of an issue is disabled from bringing to its decision that dispassionate judgment which Anglo-American tradition demands of officials who decide questions. Clearly the advocate's view ought to be presented publicly and not privately to those who decide."
>
> (Speaking of the creation of independent hearing commissioners): "A similar result can be achieved at the level of final decision on review by the agency heads by permitting the views of the investigators and advocates to be presented only in open hearing where they can be known and met by those who may be adversely affected by them."

> (Speaking of delegating authority to make preliminary determinations to appropriate officers): "Where this is done, no question can arise that the ultimate deciding officers have been biased through having made, ex parte, a preliminary determination in a case which they have later to decide." (Page 56, *Administrative Procedure in Government Agencies, Report of the Committee on Administrative Procedure Appointed by the Attorney General;* 77th Congress, 1st Session, Senate Document No. 3; 1941.)

In the present case not only did the staff *and* the Commissioners decide in advance of public hearings that a stockholders' vote would be "unnecessary" and "inappropriate" but they intervened in the proxy contest between the management and its opposition to the extent of forcing publication of their *ex parte* advance decision in order to extenuate the management's undisclosed change of position.

The Circuit Court minimized the prejudicial actions of the Commissioners in adjudicating *ex parte* prior to the public hearings one of the most crucial issues. It describes these actions as "no more than legitimate prehearing conferences" and refers to a report of the Attorney General's Committee. That report, however, at page 41 spoke of assistance in preliminary discussions so that "the facts presented" and the "factual issues" would be clearly delineated in most economic fashion. It did not approve of deciding issues of law or contested facts or questions of equity at these conferences, and as above noted the Attorney General's Committee forcibly came out against such a procedure.

The Commission at page 61 of its decision some months later in the *Commonwealth & Southern* case

(Holding Co. Act Release No. 5825) stated: "It (the staff) was careful to point out that as far as the Commission itself was concerned no expression of opinion could be made * * *." Petitioner does not raise here the question of whether the pre-hearing actions of the Commission deprived him of a fair and impartial hearing on this issue, but has merely set forth this background at some length so this Court may have before it the facts out of which the questions presented here emerged.

Reasons for Granting the Writ

1. This is the first case to present the question of whether the Securities and Exchange Commission has the power to short-cut the protective provisions of both the Public Utility Holding Company Act of 1935 and the statutes of the State of incorporation by directing a registered company to effect a plan of reorganization without first obtaining the approval of a District Court or of the affected stockholders as provided in the State law. The Circuit Court held that the provision in Section 24 (a) of the Act for review *by a Circuit Court* of an SEC order under the Act is "adequate protection" to dissenters, but this overlooks the crucial distinction that enforcement proceedings in a District Court under Section 11 of the Act were designed by Congress to confer upon dissenters the following rights:

> (i) The right to propose in the District Court an alternative plan to the company's plan. No such alternative plan can be proposed or considered in the Circuit Court on direct review of an SEC order.
>
> (ii) An automatic stay pending review by the District Court of the SEC order. The review provided by Section 24 of an SEC order in the Circuit

Court does not include the right to such a stay, which is made discretionary with the Circuit Court.

(iii) A right to a trial *de novo* of all issues respecting the fairness and equity of the plan approved by the Commission.

Should the construction of the Act urged by the Commission and upheld by the Circuit Court be allowed to stand, the rights of dissenters which Congress legislated to protect will be abruptly changed. The present interpretation increases the powers of management by destroying the safeguards of State law requiring a vote by stockholders before a reorganization plan may be effected. At the same time that these safeguards are destroyed the safeguard of a trial *de novo* by a District Court is also eliminated, while no opportunity at all will remain for stockholders to propose a plan of their own in view of the fact that the SEC proceedings under Section 11 (e) are restricted to hearings on the management's plan.*

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* The position of the SEC in this case represents a novelty and a reversal of its position in similar cases. This is believed to be the first time it has endeavored to effect a plan of reorganization without requiring, *when requested*, a stockholders vote or a District Court proceeding. See *Great Lakes Utilities Company*, Holding Co. Act Release No. 3419, plan enforced E. D. Pa., Apr. 21, 1942, unreported; *In re Columbia Oil & Gasoline Corp.*, 50 F. Supp. 965 (D. Del., 1943); *In the Matter of Commonwealth & Southern Corp.*, Holding Co. Act Release No. 5825; *In the Matter of The United Corporation*, Holding Co. Act Release No. 4478; *International Utilities Corporation*, Holding Co. Act Release No. 4896 and 4992; plan enforced without opinion S. D. N. Y., 1944; *Jacksonville Gas Company*, 46 F. Supp. 852 (S. D. Fla., 1942); *National Power & Light Company*, 10 SEC 827 (1941); *Puget Sound Power & Light Co.*, Holding Co. Act Release No. 4255, plan en-

2. The interpretation of the statute in this case by the Second Circuit is in conflict with the construction of the Third Circuit in *Commonwealth & Southern Corporation* v. *Securities & Exchange Commission,* 134 F. (2d) 747 (1943); and with the practice in prior cases.

In the *Commonwealth & Southern* cases, as here, the Commission had issued an order under Section 11 (b) (2) of the Act requiring Commonwealth & Southern Corporation to divest itself of its preferred stock. The order required the corporation to change its capitalization to one class of stock "in appropriate manner, not in contravention of said Act or the rules, regulations and orders promulgated thereunder * * *". The Commission did not, however, seek to avoid a vote of stockholders or enforce the *method* by which the corporation should carry out the order, as it has done here. And when the order was attacked by the corporation, the Commission urged,

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forced without opinion, D. Mass. (1943); *Southern Colorado Power Co.,* Holding Co. Act Release No. 4501, plan enforced without opinion, D. Colo., 1944; *Standard Gas and Electric Co.,* 59 F. Supp. 294 (D. C. Del.), 151 F (2d) 326 (C.C.A. 3rd); *United Light & Power Co.,* 51 F. Supp. 217 (D. Del., 1943), 142 F. (2d) 411, (C.C.A. 3rd, 1944); affirmed under title *Otis & Co.* v. *Securities & Exchange Commission,* 323 U. S. 624.

In none of the cases cited by the Commission in its decision was a request made for a vote or a District Court proceeding. The *Commonwealth & Southern* case of 1945 cited here is almost an exact parallel to the present case in that both companies were proceeding under a similar Commission order to reduce their capitalization to one class of stock, both sought the same method of compliance, and both are Delaware corporations. United alone was relieved, however, of the necessity for a Court proceeding, even though its management originally asked for a stockholders vote.

and the court held, that the order was within the Commission's powers under Section 11 (b) *because the order was not self-executing and would have to be enforced under Sections 11 (d) or 11 (e) if the stockholders could not agree on a plan of recapitalization.* In the present case holders of only 45% of the Preference Stock accepted the plan without the approval being sought of the remaining 55% of the Preference Stock and of the 100% of Common Stock affected thereby.

The court's opinion in the *Commonwealth and Southern* case adopted the Commission's views as to its powers under the statute. The court said (134 Fed. 2d 747 at 752):

> "For it is clear that Congress intended that the subject company should be given an opportunity, as is done by this order, to procure the voluntary assent of its stockholders to an appropriate plan or, if it is unable to procure such assent, to propose an appropriate plan to accomplish the result and to secure its enforcement by the district court as against nonassenting stockholders."

In the present case the Commission has done the very thing which it successfully argued in the *Commonwealth and Southern* case it lacked the power to do, *viz.*, to enforce a plan of reorganization without the approval of stockholders or of a court under Sections 11 (d) or 11 (e) of the Act.

The construction of the statute which the Commission and the courts have until now adopted is clearly stated in the *Commonwealth and Southern* opinion:

> "While these orders are final and binding determinations of the result to be achieved it seems clear that Congress intended that the Commission might leave open for later consideration the detailed means by which the result directed should be accomplished.

> It is obvious that in many cases the desired result may be reached in more than one way. Congress evidently intended to permit the Commission to leave to the company involved the initiative in suggesting from among the available alternative methods that one which it deems most appropriate. This seems clear in the light of the fact that under section 11 (e) the company is not restricted to proposing a plan of compliance which it is in a position to carry out itself but it may also propose a plan affecting the rights of third persons which it may, through the Commission, request a court to enforce against the opposition of those third persons. It is only if the company does not propose *a plan which the Commission and the court approve* that the Commission under section 11 (d) itself may propose and seek enforcement of a plan against the opposition of the company." (134 Fed. 2d, at 751.) (Emphasis supplied.)

As in the present case the subject of the Commission's order was a Delaware corporation. At page 25 of its brief in the *Commonwealth & Southern* case the Commission's counsel argued, in answer to the Company's contention that it was unable to carry out the order required of it by the Commission, as follows:

> "If it be fully understood that Section 11 as a whole, of which Section 11 (b) (2) is but a part, is in the nature of a corporate reorganization statute *in which powers not possessed by managements* are to be supplemented or reenforced by the Commission *and the courts,* Commonwealth's arguments all fail." (Emphasis supplied.)

And at page 31 of its brief the Commission therein stated:

> "The purpose of a simple order such as is here involved is to afford the holding company an oppor-

> tunity to work out its own destiny under the Act rather than to impose upon it a ready-made plan. Such an order gives the holding company a chance to achieve compliance through obtaining consents to a plan from its security holders or through submitting a plan to the Commission and to the courts. The order thus avoids prescribing methods and procedure which might appear less desirable to the parties affected than alternative methods or procedure which might be equally proper under the statute."

And the Commission goes on to quote at page 32 of its brief from a report of the National Power Policy Committee which stated:

> " 'Furthermore it seems administratively advisable that every opportunity be offered the owners of holding company securities to work out their own processes of dismantling.' "

And concludes Commission's counsel at page 34 of the Commonwealth brief:

> "Thus Section 11 and the Commission's Order in this case invite Commonwealth and other persons having a bona fide interest to participate actively in the formulation and submission of an acceptable plan. * * * If they do not accept the opportunity, Section 11 (d) permits enforcement of the Order through the means of a plan of reorganization proposed by an interested person or by the Commission, subject to the approval of the Commission and of the District Court."

The Commission's view of the statute prevailed. In the present case the Commission has done the very thing which it contended in the *Commonwealth & Southern* case it lacked the power to do. It has attempted to enforce a reorganization plan without the approval of stockholders

or of a court under Section 11 (d) or (e) of the Act. Nor may it be argued that since acceptance of the Plan of reorganization was voluntary with the Preference Stockholders the Plan was enforceable without a stockholders' vote or a court order as against 100 per cent of the Common Stockholders and the 55 per cent non-assenting Preference stockholders. No such loophole was left by the Commission in its Commonwealth brief, and indeed the theory would be novel in reorganization law. Obviously the Preference stockholders would voluntarily accept any plan that enriched them, regardless of the other stockholders' protests. Reorganization statutes requiring votes and court scrutiny are for the very purpose of obviating such practices. The present plan moreover is also a plan of dissolution, and such plans under Section 39 of the Delaware Corporation Law require the consent of two-thirds in interest of the Stockholders having voting power.

3. This case raises for the first time the issue of how long the SEC may defer according to stockholders the benefits of legislation which Congress enacted more than 10 years ago and which were to be effected "as soon as practicable after January 1, 1938". The admitted unfair distribution of voting power continues unabated into its eighth year despite the explicit direction of Congress to effect a cure promptly, and in the absence of any SEC finding that such a cure would be impracticable. At the hearings on the Plan herein under review the uncontroverted evidence before the Commission showed (R. Part II, pp. 21-22a; and p. 34 of p. 3a):

> (1) The management of The United Corporation had been able to perpetuate itself in office from 1939 through 1944 by requiring that only 25 per cent of

the total voting stock was necessary to make a quorum for the election of directors at annual meetings of the stockholders. Thus, little more than 12½% of the voting stock may control the corporation.

(2) The management had never received the vote of a majority of the voting stock from 1939 through 1944.

(3) At the Annual Meeting in 1943 more than 14,000 stockholders voted in opposition to the management but were unable to seat a single director because the vote was counted non-cumulatively although these stockholders cast more than 21 per cent of the votes cast at the meeting. The management however re-elected 100 per cent of the Directors with a vote of only 39 per cent of the total voting stock outstanding, which vote was cast by 19,000 stockholders. Approximately the same situation was shown to exist at the 1944 Annual Meeting.

This evidence was received by the Commission at the hearings, and Petitioner alleged without challenge that it demonstrated a maldistribution of voting power. To cure this maldistribution Petitioner asked the Commission to impose as conditions to any approval of the Plan (1) that the Company raise its quorum requirement to 50 per cent, (2) institute cumulative voting at annual meetings for election of directors, and (3) grant adequate representation on the board to the stockholders in opposition to the management. Although the Commission recognized the maldistribution of voting power in its decision, it denied Petitioner's requests on the sole ground that they were not "germane" to the issues before it, but added they might be imposed "in a different kind of proceeding" (R. Part II, p. 34 of p. 3a). Petitioner has asked the Commission to inform him what such a proceeding would be, but to date

he has received no enlightenment on that score. The Circuit Court's remarks that Petitioner's amendments appear designed "to secure for petitioner that position in company affairs for which he waged a (losing) proxy battle" overlooks the crucial fact that Petitioner and his more than 14,000 associated stockholders were denied any representation on the board, a denial that could not have been made effective under an equitable system of voting. The proxy contest was waged moreover to secure a majority of the seven man board, while the amendments here sought, if effected, would at most have accorded a minority of two members of the board to Petitioner.

The Plan was filed by the Company under Section 11 (e) of the Act. By so filing the Plan the Company invoked the comprehensive jurisdiction of the Commission, and the Commission had the power to embrace in the proceeding all issues relevant to Section 11 of the Act. This is so because an 11 (e) Plan is subject to modification by the Commission so as to bring it into conformity with the requirements of 11 (b). The failure of the Company to include in the Plan a provision for curing the maldistribution of voting power does not defeat the power of the Commission to modify the Plan so as to include in it amendments to that effect. Any other ruling would limit the jurisdiction of the Commission, and would contravene the Congressional mandate that the Commission effect a cure in maldistribution of voting power "as soon as practicable".

It is indeed surprising that the Commission which was given a mandate to effect this cure as soon as practicable "after January 1, 1938" should be a party to a further delay. In ruling as it did the Commission deprived Petitioner of the benefits of the Act which Congress intended to confer upon the stockholders. The 11 (e) hear-

ing was a proper proceeding for the effectuation of the cure. Furthermore the application of the Company was filed also under Sections 12 (c) and (d) which empowers the Commission to issue orders to prevent the circumvention of the provisions of the Act. Approval of the Plan without imposition of the requested conditions enables the management of United to continue its circumvention of the Act's provisions relating to fair and equitable distribution of voting power. Petitioner was entitled to the benefits of the Act "as soon as practicable". The evidence showing the maldistribution was received at the hearings as germane to the issues; it was undisputed; and the maldistribution is conceded by the language of the Commission's decision. Petitioner has no authority to bring an independent proceeding to effect the cure. It is the Commission's duty to effect a cure as soon as practicable. A hearing has been held on the issue, evidence received, and the Company given ample opportunity to be heard. What is to be gained by requiring the Company to propose a plan for effecting the cure at a second and separate 11 (e) proceeding? Only a delay in time. And such a delay is prohibited by the terms of the Act requiring the Commission to act "as soon as practicable". It is now more than eight years after January 1, 1938. The Commission has not claimed it is impracticable to impose the conditions; only that they are not "germane". This is clearly an error as to the scope of Section 11 (e) and the Commission's powers thereunder.

Respondent United in attempting to rebut this point referred the Circuit Court to a denial by the Commission of petitioner's similar request in a different proceeding. (*In the Matter of The United Corporation,* Holding Co. Act Release No. 5555, (1945)). This omits one vital point. That proceeding was held to determine if United had been

dilatory in complying with the order of August 14, 1943, *which was based on a record closed in 1942.* Petitioner's request for the amendments proposed was based on the evidence of events occurring in 1943 and 1944, and therefore the Commission may have properly exercised its discretion in refusing to adopt the amendments in that proceeding.

Since the closing of the present proceeding, based on a record which includes the happenings of 1943 and 1944, the Commission has abandoned the ground on which it denied the relief sought. That ground was that the amendments were not "germane" to the issues before it in an 11(e) proceeding. Some months later in the *Commonwealth & Southern* case (Holding Co. Act Release No. 5825), the Commission itself incorporated in an 11(e) plan one of the very conditions asked by petitioner and denied, namely institution of cumulative voting (*Id.*, pp. 50-51). And though by this action it in effect admits that it wrongfully denied petitioner the relief sought on this score in the present proceedings, it has not taken any step to amend its orders.

CONCLUSION

It is respectfully submitted that this petition for a writ of certiorari should be granted.

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April 13, 1946.